The Lack of Inventory And Its Effect On Market Conditions And Negotiating Strategies

By Michael Feldman, Romer Debbas, LLP

The housing market in Manhattan in 2012 and thus far in 2013 has been characterized by an unprecedented lack of inventory. According to industry reports, the number of listings fell in excess of 34% from prior levels to a 12-year low. When coupled with the largest fourth quarter sales volume in 25 years, historically low interest rates, a scarcity of new development projects and increased foreign investment, prospective purchasers are having an increasingly difficult time locating suitable properties and "winning out" over other would-be buyers. Although a considerable uptick in sales at the end of last year (sales rose as much as 40% in the last three months of 2012) was expected by many industry experts because many sellers were looking to close deals prior to the imposition of increased capital-gains tax rates in 2013, we have seen a dramatic increase in sales so far this year despite ever-decreasing inventory.

It is no surprise therefore that as supply continues to decrease to levels not seen since the new millennium with a corresponding increase in demand, the current climate favors sellers over buyers. It's not uncommon to hear stories of over 50 people at open houses (some of whom make offers on the spot), "Best and Final" scenarios, cash offers well above asking price and demands that contracts get signed within 48 hours of an accepted offer. Some sellers increase this urgency by instructing their attorneys to send contracts out to multiple prospective buyers, essentially creating a "race" to contract signing. Given these market conditions, we've seen a considerable increase in cash buyers and those who are willing to proceed without mortgage contingencies. It would seem that many sellers expect, if not insist upon, a "safer" buyer profile, especially with respect to sales of cooperative units which are subject to the heightened scrutiny of cooperative boards.

Notwithstanding this dramatic change in market conditions from two to three years ago, sellers still need to make smart decisions about listing their apartments and their approach to negotiations. As always, some listings will move more quickly than others, and even with the increased demand and decreased inventory, pricing still needs to be justified. When pricing is in line with the market, as opposed to testing the market with a price that the market does not support, we've seen more interest and "Best and Final" bidding which serves to drive prices up. Sellers might also consider trading the assurance of an all-cash or non-contingent offer for a higher priced offer that is contingent on financing, assuming the prospective purchaser is properly vetted. Additionally, if the property generates a lot of interest, and the prospective purchaser is flexible in terms of a move-in date, sellers may also have the opportunity (if needed) to negotiate the right to occupy the unit for a period of time post-closing at little or no cost, which could make the moving process much easier.

Of all sellers, developers of new construction projects in Manhattan (especially those that have generated a lot of buzz and where a large percentage of units are sold prior to construction) seem to have taken the most advantage of current market conditions. In recent transactions we have worked on, sponsors have imposed some, if not all, of the following conditions on buyers:

- No financing contingencies;
- Buyer pays transfer tax (which is normally a seller's expense and in properties over $500,00.00 is a total 1.825% of the purchase price [1.425% to NYC and 0.4% to NYS]);
- Buyer pays developer's attorney's fees (which are usually in the range of $2,000.00-$3,000.00);
- Strict deadlines in which to sign contract and remit downpayment;
- Increased initial downpayments (up to 15% of the purchase price) and requirement of an additional downpayments of up to 5% (usually within six months of contract signing);
- Unwillingness to provide for "drop dead" dates whereby the buyer receives a refund of their downpayment if the Unit is not ready for delivery by a date certain;
- Buyer pays a proportionate share (based on their percentage of common interest as set forth in the Offering Plan) of the cost of purchasing the resident manager's unit, which can be very costly depending on the building; and
- Absolutely no negotiation on price.

Therefore, prospective purchasers who wish to buy in some of New York City's most popular development projects should be aware that there is a high likelihood that they will incur traditional seller-related costs with little or no room for negotiation. This can be starkly contrasted to just a few years ago, where most developers not only paid for their own closing costs, but also routinely extended financing contingencies and sometimes even offered monetary concessions to entice buyers. Today's market simply dictates that buyers of units in popular new developments have no choice to absorb such costs, as other motivated buyers, especially investors with an abundance of cash, merely view them as a cost of doing business.

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